SCS Agency
Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author: McPherson | Analyst: Roger Lackey | Bill Number: SB 1402

Related Bills: See Legislative History | Telephone: 845-3627 | Amended Date: 02-12-98

Attorney: Doug Bramhall | Sponsor:

SUBJECT: Irrigation Equipment Credit

____ DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended _____.

____ AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

____ AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced/amended _____.

____ FURTHER AMENDMENTS NECESSARY.

____ DEPARTMENT POSITION CHANGED TO _____.

____ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED/AMENDED _____ STILL APPLIES.

X OTHER - See comments below.

SUMMARY OF BILL

Under the Personal Income Tax Law (PITL) and the Bank and Corporation Tax Law (B&CTL), this bill would allow a tax credit equal to 15% of the cost to purchase and install qualified water application or distribution equipment that is placed in service in this state, is used in a business for the production of farm income on agricultural land owned or leased by the taxpayer and provides water conservation or savings. The credit for a parcel of land would not exceed the lesser of $1,000 per acre of land served by the qualified water application or distribution equipment or $1 million.

SUMMARY OF AMENDMENT

The February 12, 1998, amendment added the language discussed in this analysis, and deleted the language regarding the valuation of irrigation equipment improvements on agricultural land for property tax purposes.

No analysis was completed for this bill as introduced January 13, 1998.

EFFECTIVE DATE

This bill is a tax levy and would be effective immediately upon enactment. The

DEPARTMENTS THAT MAY BE AFFECTED:

____ STATE MANDATE ____ GOVERNOR'S APPOINTMENT

Board Position:	Agency Secretary Position:	**GOVERNOR'S OFFICE USE**
____ S ____ O	____ S ____ O	
____ SA ____ OUA	____ SA ____ OUA	Position Approved ____
____ N ____ NP	____ N ____ NP	Position Disapproved ____
____ NA ____ NAR	____ NA ____ NAR	Position Noted ____
___X___ PENDING	DEFER TO _____	
Department/Legislative Director Date	Agency Secretary Date	By: Date:
Gerald H. Goldberg 3/10/98		

bill would apply to taxable or income years beginning on or after January 1, 1998, and before January 1, 2003.

LEGISLATIVE HISTORY

AB 1081 (1998), AB 1585, AB 188 (95/96), AB 2759 (1994); AB 710 (1993); AB 3375 (1990); AB 1701 (1989); SB 1034 (Stats. 1977, Ch. 1100)

PROGRAM HISTORY/BACKGROUND

A similar tax credit for the purchase and installation of water irrigation systems expired on December 31, 1985. That credit, taken in the year of installation, was the lesser of 10% of the cost or a maximum of $500, and was provided in addition to any other qualified deductions.

SPECIFIC FINDINGS

Existing state and federal laws generally allow a depreciation deduction for the obsolescence or wear and tear of property used in a business or investment property. The property must have a limited, useful life of more than one year and includes equipment, machinery, vehicles and buildings but excludes land. Property is assigned to specific classifications related to the number of years of its useful life. The property then may be depreciated over the number of years of its useful life (recovery period).

Existing state and federal laws allow a taxpayer to deduct expenses paid or incurred in the ordinary course of a taxpayer's business. Expenses related to water conservation qualify to the extent there are an ordinary and necessary business expense and not the purchase of property with a useful life of more than one year.

Existing state and federal laws allow taxpayers to use various credits against tax. Neither state nor federal law has a tax credit similar to the one proposed by this bill.

This bill would allow taxpayers that own or lease agricultural land to take a credit against tax for costs paid or incurred for purchasing and installing qualified water application or distribution equipment. The equipment in the taxable year would be required to conserve or save at least 10% in comparison to the water used on the same land in the prior taxable year.

This bill would define "qualified water application or distribution equipment"; "water conservation or savings"; "agricultural land"; "land served"; and "parcel of land."

No credit would be allowed unless a registered civil engineer, registered agricultural engineer, or certified irrigation designer, independent of the purchaser, seller or manufacturer of the equipment, provides a certification to the taxpayer prior to the purchase of the equipment certifying that the equipment meets the required water conservation or savings.

The taxpayer would be required to provide that certification to the Franchise Tax Board (FTB) upon request.

The excess credit could be carried over indefinitely to reduce the taxpayer's tax liability in future years.

Any carryover credit in the next taxable year or subsequent income years would be disallowed if the taxpayer disposed of the land on which the qualified equipment was installed.

The basis of the qualified equipment would be reduced by the amount of the allowable credit.

Policy Considerations

Because this bill requires an adjustment to basis, it creates a state and federal difference and would increase the complexity of tax preparation.

Implementation Considerations

The following implementation concerns have been identified. Department staff is available to work with the author's office to resolve these concerns.

It is unclear what is meant by "receive the credit once." The term "receive the credit once could mean $1 million or 15% ($1,000/acre) for a taxpayer regardless of how many parcels of land is owned or could apply to each parcel. In addition, it is unclear if "once" would mean in only one income or taxable year, or for one installation.

Items which may be included in the cost of the equipment and installation are not identified. Without more specific guidelines, audit would be difficult since it is unclear which costs are covered by the credit. For example, it is unclear if the cost of obtaining the certification would be included in the cost of installation.

The phrase "independent of" is a subjective standard and may be open to various interpretations. To clarify the term and eliminate differences in interpretation, the language should specify an objective relationship. Providing an objective relationship would make it clear that the certifying civil engineer, registered agricultural engineer or certified irrigation designer may not be an employee or otherwise related to the purchaser, seller or manufacturer of the water application or distribution equipment.

The bill provides that the water conservation or savings of at least 10% in comparison to the water used on the agricultural land in the prior income year. Water conservation equipment installed on land that has lain fallow or currently has no irrigation system would not be eligible for the credit if the use of a water application or distribution system actually would increase the amount of water used on the land.

This credit does not limit the carryover period. Current policy has been to provide a limited carryover period for most credits. Experience indicates carryover is typically exhausted in eight years.

FISCAL IMPACT

Departmental Costs

The departmental costs are difficult to determine with the concerns raised in this analysis unresolved. However, if the concerns are resolved, the departmental costs are expected to be minimal.

Tax Revenue Estimate

The revenue analysis is estimated to impact PIT and B&CT revenue as shown in the following table.

Fiscal Year Cash Flow Income/Taxable Years Beginning After December 31, 1997 Enactment Assumed After June 30, 1998 $ Millions			
1998-9	1999-00	2000-01	2001-02
($4)	($6)	($6)	($7)

This analysis assumes that the installation must take place in California, and excludes crop rotation from high water to low water use as a way of qualifying less efficient technology for the credits. Any changes in employment, personal income, or gross state product that could result from this measure are not considered.

Revenue Discussion

This estimate was developed in several steps. First, according to the 1997 California Statistical Abstract, there are approximately 9 million acres irrigated annually in California. Second, according to the Department of Water Resources (DWR) 30 year projections of irrigated acres in California, approximately 40% of statewide acreage of farmland would be irrigated by qualified water application or distribution equipment. Applying this percentage to the total number of irrigated acres in California, it was projected that approximately 3.6 million qualified acres would adopt water saving technology. Third, from discussions with industry representatives, it was concluded that the average life of water savings equipment is about 15 years. Thus, in a given year approximately 1/15th of the estimated irrigated land would replace and invest in water technology. Fourth, the average cost per acre to install the equipment was calculated at $481 per acre for 1998. Fifth, the total expenditures were calculated based on the cost of equipment and a 15% credit was applied to arrive at total qualified credit amounts. The applied credit amounts were adjusted to account for the reduction in depreciation that would result from the use of the credits. Based on projections for agriculture land use, a negative two-tenths of a percent per year growth rate was used to adjust the total number of acres irrigated. The portion of credits that could be applied in any given year was estimated using tax returns that report farm income. It was assumed that unapplied carryover credits would be exhausted by the fourth year.

BOARD POSITION

Pending.